

A10-2090

State of Minnesota  
In Supreme Court

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Tammy Pepper,

Respondent,

v.

State Farm Mutual Automobile Insurance Company  
a/k/a State Farm Fire and Casualty Company  
a/k/a State Farm Insurance Companies,

Appellant.

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**BRIEF AND ADDENDUM OF RESPONDENT TAMMY PEPPER**

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The appendix to this brief is not available for online viewing as specified in the *Minnesota Rules of Public Access to the Records of the Judicial Branch*, Rule 8, Subd. 2(e)(2).

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## STATEMENT OF THE ISSUE

WHETHER AN AUTOMOBILE INSURANCE POLICY MAY EXCLUDE UNDERINSURED MOTORIST BENEFITS TO AN INJURED CLAIMANT WHEN THERE ARE MULTIPLE TORTFEASORS AND THE CLAIMANT IS NOT ATTEMPTING TO CONVERT FIRST-PARTY UNDERINSURED MOTORIST COVERAGE TO THIRD-PARTY LIABILITY COVERAGE.

The district court granted State Farm's motion for summary judgment. The Court of Appeals reversed, holding the automobile insurance policy exclusion was overbroad and omitted coverage required by Minnesota law.

*Latterell v. Progressive N. Ins. Co.*, 801 N.W.2d 917 (Minn. 2011).

*Kelly v. State Farm Mut. Auto. Ins. Co.*, 666 N.W.2d 328 (Minn. 2003).

## STATEMENT OF THE CASE AND FACTS

Appellant/Defendant State Farm appeals the decision of the Court of Appeals and requests this Court reinstate the trial court's grant of summary judgment to State Farm. Respondent Tammy Pepper requests that this Court affirm the decision of the Court of Appeals and remand the case to the district court for further proceedings.

Respondent Tammy Pepper (Pepper) was standing outside a home owned by her mother and stepfather, Frank Matlachowski (Matlachowski) when she was struck by a vehicle owned by her sister, Tracie Drew (Drew). (Pet. App. at 92). In the moments before the accident, Pepper was standing approximately ten feet behind the vehicle when Matlachowski, the driver, pressed on the accelerator and it stuck "wide open," pushing Pepper into a wall and injuring her. (Pet. App. at 92). At the time of the accident, Drew knew the vehicle accelerator was defective, but Drew did not warn Matlachowski of the defect. (Pet. App. at 96). Drew owned and maintained the vehicle, and she insured it through State Farm Mutual Insurance Company (State Farm). After the accident, State Farm paid Pepper \$100,000 in liability coverage.

At the time of the accident, Matlachowski and his wife had two separate State Farm policies insuring different vehicles. (Pet. App. at 93). Each policy declarations page stated coverage of \$100,000 in liability limits and \$100,000 per person in underinsured motorist (UIM) coverage. (Pet. App. at 92-93). The policies insured different vehicles and State Farm collected separate premiums for each policy. Each

policy listed Pepper as a driver. (Pet. App. at 102-03). Pepper received \$100,000 from one of the State Farm policies to settle any potential “liability” claim against Matlachowski. (Pet. App. at 91). Although State Farm collected premiums on the other policy, it paid nothing to Pepper under the policy because of a policy exclusion. Pepper filed suit to obtain UIM benefits under the State Farm policy that had not paid liability benefits. For purposes of this appeal of summary judgment, both Drew and Matlachowski may be deemed at fault. It is disputed whether Pepper was a resident of the Matlachowski household. At the time of the accident, Pepper was underinsured. She has since incurred medical bills in excess of \$170,000. (Pet. App. at 92).

### ARGUMENT

#### **THE STATE FARM POLICY PROVISION EXCLUDING UIM COVERAGE TO PEPPER IS OVERBROAD BECAUSE IT EXCLUDES FIRST-PARTY BENEFITS WHERE THERE IS NO COVERAGE CONVERSION.**

##### **A. This Court’s Standard Of Review Is *De Novo*.**

The facts of this case are largely undisputed. The district court applied the law to those undisputed facts and granted summary judgment to State Farm. Pepper appealed, and the Court of Appeals reversed. When, as in this case, “a district court grants summary judgment after applying the law to undisputed facts, the legal conclusion is reviewed *de novo*.” *Auto-Owners Ins. Co. v. Forstrom*, 684 N.W.2d 494, 497 (Minn. 2004). Because statutory construction and interpretation of insurance contracts are “legal issues,” conclusions on those issues are also subject to *de novo* review. *Id.*

**B. The Facts Of This Case Do Not Give Rise To Coverage Conversion.**

As this Court has made clear, “[c]overage conversion occurs when underinsured motorist benefits are used as a substitute for the tortfeasor’s inadequate liability coverage.” *Kelly v. State Farm Mut. Ins. Co.*, 666 N.W.2d 328, 331 (Minn. 2003). State Farm relies upon this Court’s holding in *Kelly* to support its argument that Pepper, in obtaining liability benefits from a State Farm insurance policy owned by Matlachowski and seeking UIM benefits from a separate State Farm insurance policy owned by Matlachowski, is attempting to convert first-party UIM coverage to third-party liability coverage. (Brief of Petitioner at 15-17).

This case is distinguishable from *Kelly* because *Kelly* involved the acts of a single tortfeasor. In *Kelly*, Kelly’s husband negligently drove his Dodge Intrepid, causing injuries to Kelly, his passenger. *Kelly*, 666 N.W.2d at 329. Kelly brought a claim against her husband, which State Farm settled by paying the liability limit on the Intrepid. *Id.* Because her injuries exceeded the liability limit paid by State Farm, Kelly filed a claim with State Farm for UIM benefits under an insurance policy covering the Pontiac Grand Am Kelly owned with her husband. *Id.* Both Kelly and her husband were named insureds on the insurance policy covering the Grand Am. *Id.* State Farm denied Kelly’s claim for UIM benefits, “contending that under the Grand Am policy the Intrepid was not an ‘underinsured motor vehicle’ and that allowing Kelly to recover UIM benefits under the Grand Am policy, which also provided liability coverage to her husband, *the*

*tortfeasor*, would result in coverage conversion[.]” *Id.* (emphasis added). Kelly filed suit against State Farm, the district court entered judgment in favor of State Farm on the UIM issue, and the Court of Appeals affirmed. *Id.* at 329-30.

On appeal, this Court affirmed the ruling of the Court of Appeals and reiterated that, “[w]hen a liability claim is made on one policy and a UIM claim is made on a second policy, both of which list *the tortfeasor* as an insured, allowing the UIM claim would result in the payment of additional benefits for injuries caused by the negligence of *the insured tortfeasor*, which is, as we stated in *Lynch*, the ‘essence of liability coverage.’” *Kelly*, 666 N.W.2d at 331 (quoting *Lynch v. Am. Family Mut. Ins. Co.*, 626 N.W.2d 182, 188 (Minn. 2001)) (emphasis added). In the present case, Pepper’s injuries are the result of the acts of multiple tortfeasors, Drew and Matlachowski, and the holding and rationale of *Kelly* are therefore inapplicable.

In addition to *Kelly*, State Farm looks to the line of coverage conversion cases decided by this Court to contend that Pepper is attempting to convert first-party UIM coverage to third-party liability coverage. (Brief of Petitioner at 10-20). Because of its unique facts, however, this case is distinguishable from each case in that line. In *Myers v. State Farm Mut. Auto. Ins. Co.*, this Court concluded that the heirs of a deceased passenger could not collect UIM benefits under the vehicle owner’s insurance policy. 336 N.W.2d 288, 290 (Minn. 1983). *Myers* is inapplicable, however, because “[t]he *Myers* rule ar[ose] out of a fact pattern where the same person own[ed] the at-fault

vehicle and the policy under which the injured claimant s[ought] first-party coverage.” *Petrich v. Hartford Fire Ins. Co.*, 427 N.W.2d 244, 245 (Minn. 1988). In *Petrich*, this Court concluded an individual injured in one car could not collect UIM benefits from his stepfather’s policy on another car. *Id.* Like *Myers*, this Court’s holding in *Petrich* involved a scenario in which the same person owned the at-fault vehicle and the policy under which the injured claimant sought UIM benefits. *Id.* at 246. In *Meyer v. Ill. Farmers Ins. Grp.*, this Court held that an insured could not collect UIM benefits from the same automobile insurance policy that provided liability coverage. 371 N.W.2d 535, 536 (Minn. 1985). Finally, in *Lynch*, this Court concluded that a son could not recover UIM benefits under his father’s automobile policy because that policy had already paid liability benefits. 626 N.W.2d at 189. It is undisputed that Pepper sought UIM benefits under a State Farm policy that had not paid liability benefits, rendering *Meyer* and *Lynch* inapplicable.<sup>1</sup>

Both policies issued by State Farm to Matlachowski contained a policy provision stating that “If two or more vehicle liability policies issued by us to *you, your spouse, or any relative* apply to the same accident, the total limits of liability under all such policies

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<sup>1</sup> In the appeal below, State Farm also relied on the Court of Appeals’ decisions in *Lahr v. Am. Family Mut. Ins. Co.*, 551 N.W.2d 732 (Minn. Ct. App. 1996), and *Mitsch v. Am. Nat’l Prop. & Cas. Co.*, 736 N.W.2d 355 (Minn. Ct. App. 2007), *review denied* (Minn. Oct. 24, 2007). This case is distinguishable from *Lahr* and *Mitsch*, as the Court of Appeals noted, because those cases “dealt with a second tortfeasor driving a second vehicle.” (Add. 7). In the present case, “we have a second tortfeasor, whose liability is grounded in her ownership of a motor vehicle, but we have no second vehicle.” (Add. 7).

shall not exceed that of the policy with the highest limit of liability.” (Brief of Petitioner at 4). Because both policies had a \$100,000 liability limit, State Farm paid \$100,000 to Pepper. In essence, because State Farm paid the liability limit on only one policy, State Farm received a windfall by keeping profits it obtained through collecting liability premiums on both policies. State Farm, by excluding Pepper from receiving UIM benefits under the State Farm policy that did not provide liability coverage, is now attempting to obtain a second windfall by not providing UIM benefits required by Minnesota law.

State Farm has not identified a single case with facts analogous to the facts surrounding Pepper’s injuries to support its argument that Pepper is attempting coverage conversion.<sup>2</sup> As such, the Court of Appeals correctly determined that this case does not present an instance of coverage conversion, but rather presents a matter of first impression in Minnesota. (Add. 7). The issue is whether the policy exclusion written by State Farm, “which is framed to prevent UIM coverage on a ‘motor vehicle’ that is ‘insured under the liability coverage of this policy,’” is overbroad, omitting coverage required by Minnesota law. (Add. 7).

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<sup>2</sup> As the Court of Appeals noted, “State Farm, like the district court, notes the absence of authority going beyond the fact situations in *Lahr* and *Mitsch*, but offers no precedent dealing with the factual situation before us. Rather, State Farm rests on its exclusion[.]” (Add. 7).

**C. The State Farm Policy Exclusion Denying UIM Benefits To Pepper Is Overbroad, Omitting Coverage Required By Minnesota Law.**

Insurance contracts are contracts of adhesion. *Travelers Indem. Co. v. Bloomington Steel & Supply Co.*, 718 N.W.2d 888, 895 (Minn. 2006) (citing *Canadian Universal Ins. Co. v. Fire Watch, Inc.*, 258 N.W.2d 570, 574-75 (Minn. 1977)). Even so, the general rule for the construction of insurance contracts is “that parties are free to contract as they desire, and so long as coverage required by law is not omitted and policy provisions do not contravene applicable statutes, the extent of the insurer’s liability is governed by the contract entered into.” *Am. Family Mut. Ins. Co. v. Ryan*, 330 N.W.2d 113, 115 (Minn. 1983). In determining whether a policy provision contravenes an applicable statute or omits coverage required by Minnesota’s automobile insurance laws, this Court “attempt[s] to determine what the legislature intended by the relevant statute.” *Carlson v. Allstate Ins. Co.*, 749 N.W.2d 41, 46 (Minn. 2009); see Minn. Stat. § 645.16 (“The object of all interpretation and construction of laws is to ascertain and effectuate the intention of the legislature.”); see also *Kwong v. Depositors Ins. Co.*, 627 N.W.2d 52, 55 (Minn. 2001) (“[P]olicy terms that conflict with the No-Fault Act will be held invalid.”).

UIM coverage is first-party coverage required by Minn. Stat. § 65B.49, subd. 3a(5) “to protect the named insured and other additional insureds from suffering an inadequately compensated injury caused by an accident with an inadequately insured automobile.” *Kelly*, 666 N.W.2d at 331 (quotation omitted). In relevant part, subdivision

3a states that “Each [UIM] coverage, at a minimum, must provide limits of \$25,000 because of injury to or the death of one person in any accident and \$50,000 because of injury to or the death of two or more persons in any accident.” Minn. Stat. § 65B.49, subd. 3a(1).

Almost invariably, insurance policies contain exclusions that limit the availability of UIM benefits.<sup>3</sup> The State Farm policy at issue in this case contained one such exclusion, which purported to prohibit Pepper from recovering UIM benefits under the State Farm policy that did not pay liability benefits. State Farm argues that, because its exclusion in this case is unambiguous,<sup>4</sup> the exclusion is valid under the No-Fault Act. This Court has stated that “[t]he validity of an exclusionary provision in an insurance policy may depend on whether the exclusion applies to first- or third-party coverage . . . [b]ecause the No-Fault Act leaves unaltered the basic framework of the law of liability insurance, but imposes restrictions on the ability of insurers to exclude first-party benefits.” *Latterell*, 801 N.W.2d 917, 922 (Minn. 2011) (citations and quotations omitted). Because the “No-Fault Act’s primary purpose is to ensure the availability of

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<sup>3</sup> An “exclusion” is “a limitation of liability or a carving out of certain types of loss to which the coverage or protection of the policy does not apply.” 17 Samuel Williston & Richard A. Lord, *A Treatise on the Law of Contracts*, § 49:111 (4th ed. 2000).

<sup>4</sup> Insurance policy provisions are ambiguous “only when they are ‘reasonably subject to more than one interpretation.’” *Latterell*, 801 N.W.2d at 920 (quoting *Am. Commerce Ins. Brokers, Inc., v. Minn. Mut. Fire & Cas. Co.*, 551 N.W.2d 224, 227 (Minn. 1996)).

first-party benefits,’ [this Court is] more likely to invalidate exclusions to first-party coverage than to third-party coverage.” *Id.* (quoting *Lobeck v. State Farm Mut. Auto. Ins. Co.*, 582 N.W.2d 246, 249 (Minn. 1998)). As this Court has stated, the “distinction between third-party and first-party benefits is crucial when determining the validity of a policy exclusion.” *Lobeck*, 582 N.W.2d at 250.

As the Court of Appeals correctly concluded, this case does not involve coverage conversion. Thus, the policy exclusion prohibiting Pepper from obtaining UIM benefits from the State Farm policy that did not pay liability benefits is overbroad. In *Latterell*, this Court held that, because the facts of the case did not give rise to coverage conversion, the business-use exclusion at issue, which unambiguously excluded UIM benefits, was unenforceable under the No-Fault Act. *Latterell*, 801 N.W.2d at 924-25. In support of its holding, this Court unequivocally stated that, “[o]ther than in cases involving coverage conversion, . . . we have consistently invalidated policy exclusions involving first-party coverage—including UIM benefits—under the No-Fault Act.” *Id.* at 924 (citations omitted).

Finally, State Farm points to this Court’s decision in *Thommen v. Ill. Farmers Ins. Co.*, 437 N.W.2d 651 (Minn. 1989), to support its argument that “the No-Fault Act does not mandate UIM coverage be imposed in a one-vehicle accident under the same policy that provides liability coverage.” (Brief of Petitioner at 18). *Thommen* is inapplicable because Pepper is not seeking UIM coverage under the same policy that provided

liability coverage, but rather under the policy that excluded from Pepper the benefit of liability or UIM coverage. Because the unique and narrow facts of this case do not give rise to coverage conversion, and because the exclusion in the State Farm policy at issue is overbroad, Pepper is entitled under the No-Fault Act to seek UIM benefits under the State Farm policy that did not pay liability benefits.

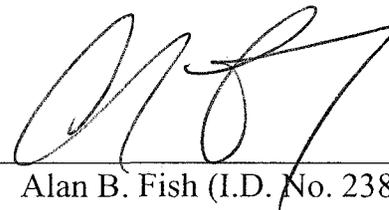
**CONCLUSION**

Pepper requests that this Court affirm the decision of the Court of Appeals and remand the case to the district court for further proceedings.

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Dated: November 7, 2011

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**CERTIFICATION OF BRIEF LENGTH**

I hereby certify that this brief conforms to the requirements of Minn. R. Civ. App. P. 132.01, subds. 1 and 3, for a brief produced with a proportional font. The length of this brief is 3,058 words. This brief was prepared using Word Perfect 8.

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